

REPLY COMMENT REGARDING COMPETITIVE BIDDING PROCEDURES FOR AUCTION No. 68

DA 06-997

AU Docket No. 06-101

This Reply Comment is directed to comments filed by Legacy Media Company, LLC (“Legacy”), Concerned Citizens of Hawaii (“CCH”), and Mullaney Engineering, Inc. (“Mullaney”).

A. The Legacy and CCH Comments are based upon an erroneous interpretation of the term “Default”.

Legacy’s Comment is substantially similar to that submitted by CCH. Legacy and CCH provide four specific examples of alleged auction “defaults” committed by Salvador Ceja (“Ceja”), Visionary Related Entertainment (“VRE”), Steven Bartholomew (“Bartholomew”), and Kemp Communications, Inc. (“Kemp”). These so-called “defaults” are discussed at greater length in the form of four bullet points presented on page 2, lines 5-33 of the Legacy Comment and page 2, lines 5-33 of the CCH Comment.

As a preliminary matter, the Legacy and CCH Comments contain a serious legal and factual error. Legacy and CCH have not properly construed the meaning of the term “default”. Pursuant to existing FCC auction procedures, in order for a default to occur, (a) an entity must be a standing high bidder for at least one allotment at the close of the auction, and (b) the entity must fail to pay its winning bid by the final payment deadline (this is now 20 days after the close of the auction). If a bidder withdraws all of its standing high bids before the close of the auction, that bidder has not

won any allotments and, hence, cannot be in “default”. Instead, such bidders are subject to an interim withdrawal payment, plus a final withdrawal payment if the winning bid in a subsequent auction is less than the amount of the withdrawn bid.

Although Legacy and CCH claim that Ceja, VRE, Bartholomew, and Kemp are defaulting bidders, this is not correct. Ceja did not win the Tecopa allotment, VRE did not win the Kihei allotment, Bartholomew did not win the Outlook allotment, and Kemp did not win the Parowan allotment. These four allotments were held by the FCC at the close of Auction 62. Accordingly, it is not even possible for the aforementioned parties to be in “default” for these allotments at this time. Instead, these four parties are subject to withdrawal payments. Since Ceja, Bartholomew, Kemp, and VRE already have substantial funds on deposit with the FCC to cover their respective bid withdrawal obligations, these parties should not be further penalized by being treated as defaulting bidders for purposes of Auction 68. It would be unfair to subject the aforementioned bidders to the same upfront payment obligations as defaulting bidders because no default ever took place. Moreover, such a policy would likely discourage full auction participation by all interested parties, making CCH and Legacy the beneficiaries of artificially depressed auction prices.

CCH and Legacy base their arguments on an erroneous interpretation of the term “default”. For example, at page 4, lines 8-9, CCH and Legacy indicate that parties such as Visionary, Ceja, Bartholomew, and Kemp “who have defaulted previously for an allotment are affirmatively barred from participating in further auctions for the frequencies in which they previously participated and defaulted.” However, as indicated above, none of these parties has defaulted. At page 4, lines 18-20, CCH and Legacy take this flawed logic a step further by asserting that the four aforementioned bidders “did not proceed on their financial obligation to the Commission”. This is factually and legally incorrect. At the close of the auction, there were no

standing high bids for any of the allotments in question (Tecopa, Outlook, Kihei, and Parowan). Therefore, no financial obligations were created in connection with any of these allotments calling for the payment of a winning bid. In contrast to CCH and Legacy's assertions, the four aforementioned bidders have already met all outstanding financial obligations to the Commission by means of interim withdrawal payments.

It is also factually and legally incorrect for CCH and Legacy to assert that these four parties (Ceja, Bartholomew, Kemp, and VRE) now owe the United States Treasury \$1,801,000 in aggregate (page 3, lines 1-5 of CCH/Legacy Comments). As stated above, no financial obligations were created in connection with any of these allotments calling for full payment of a winning bid. Moreover, no financial obligations were created calling for an immediate withdrawal payment based upon maximum potential bidder liability. Any obligation to make a full withdrawal payment has not yet matured.

CCH and Legacy's bald assertion that Ceja, Bartholomew, Kemp, and VRE owe (or will owe) the United States Treasury \$1,801,000 is idle speculation. By engaging in such "wishful thinking", CCH and Legacy hope to capitalize on the misfortunes of fellow bidders by eliminating as much of the competition as possible from Auction 68. Banning selected bidders from participating in Auction 68 will pave the way for CCH or Legacy to win these allotments at low prices without facing competing bids from those who have previously expressed interest. At the same time, banned bidders would face significant fines and penalties in the form of a "final withdrawal payment". This final withdrawal payment could greatly exceed the ultimate winning bid for a given allotment, providing an ultimate result that defies logic and common sense.

A few bidders committed serious and costly errors during Auction 37 despite the fact that these bidders were familiar with auction rules from a theoretical standpoint. Yet familiarity with auction rules from a clinical,

theoretical perspective is not the same as gaining practical experience with the rules during a real auction when actual money is at stake. Without a doubt, the mock auction was useful in terms of identifying computer connectivity problems and software interoperability issues, but woefully inadequate as a vehicle by which bidders could gain practical experience applicable to competitive, real-world bidding situations.

Some bidders did not have an opportunity to observe the practical effects of the auction rules until Auction 37 was nearing completion, with irreversible and potentially devastating consequences. Specifically, certain allotments were rotated from bidder to bidder for purposes of “parking”, with the result that at least four naïve and unsuspecting bidders were left “holding the bag” when auction activity experienced a sudden and marked decrease in the latter rounds. Parking occurs when a bidder holds an unwanted allotment in an effort to preserve eligibility for subsequent bidding on a desired allotment. The activity rule implicitly motivates parking in situations where a bidder wishes to avoid repeatedly bid on a highly coveted allotment throughout the auction until the price escalates beyond reach. But alas, there are significant hazards and pitfalls associated with parking. As bidding activity decreases in a non-linear manner, the bidder may be subjected to a severe “parking fine” or final withdrawal payment that, as mentioned above, could very well exceed the amount of a subsequent winning bid. In reality, “parking” is a trap for the unsuspecting.

Although the FCC has engaged in extensive studies of auction gaming theory, an inexperienced bidder may not have the time, resources, or expertise to do so. At the same time, the inexperienced bidder is provided with no warning for avoiding the pitfalls and potentially severe financial consequences associated with parking. The problem most commonly occurs when a bidder holds an unwanted allotment beyond mid-auction. If appropriate guidance was provided to all Auction 37 participants (including small businesspeople who lack the internal resources to engage in extensive

studies of auction theory), the four withdrawn bids cited by CCH and Legacy would not be at issue today. Likewise, similar bid withdrawal scenarios could be avoided in the future. Even though the FCC does not provide bidder-specific auction advice, it may be appropriate for the Commission to provide one or two generalized auction guidelines for the explicit purpose of avoiding the very types of undesirable situations addressed by the CCH and Legacy Comments.

The CCH and Legacy Comments contain another factual discrepancy. At the bottom of page 3, CCH and Legacy state that the conduct of the four withdrawing bidders prejudices other bona fide applicants for a given allotment. However, this is only true in situations where other bona fide applicants exist. Referring to CCH/Legacy's third bullet point on page 2, it is stated that Bartholomew was the only bidder to submit a high bid for the Outlook allotment in Auction 62. Since no other bona fide bidder stepped forward to express an interest in Outlook, no other applicants were prejudiced in this specific case.

B. The existing concept of Interim and Permanent Withdrawal Payments should be replaced by a flat 10% Permanent Withdrawal Payment that is due and payable at the end of every auction. No financial obligation on the part of the withdrawing bidder should be subject to determination in a subsequent Auction. The most effective technique for discouraging repeated bid withdrawals in successive auctions is to make each auction a completely independent event.

Despite the fact that the CCH and Legacy Comments contain some inaccuracies, they nevertheless present a few valuable ideas. Legacy and CCH state on page 1, line 12 to page 2, line 2 of their respective Comments that ...”until there is a ‘winning bid’ for a given allotment, under the Commission’s rules, there is no basis for determining the ‘deficiency payment’ that is due and no final penalty is assessed against a given defaulting (sic) auction participant.....it is in the best financial interest of the defaulting bidder if a long period of time elapses before a winning bidder for a given allotment is declared, because until a winning bidder is declared for the allotment, no ‘deficiency payment’ needs to be made. This is a loophole which must be examined, and eliminated.” We agree with CCH and Legacy that this is a significant problem. However, we disagree with CCH and Legacy as to how this problem should be resolved.

CCH and Legacy propose that the current 3% “additional” default payment (3%) be increased to 10%. However, this additional payment provision is currently applicable to defaults only, and not to withdrawals where the current 3% payment is an interim payment only, subject to subsequent adjustment in a future auction. Even if the CCH/Legacy proposal were modified to increase the current 3% interim withdrawal payment to a 10% interim payment for each occurrence of a withdrawn bid, this still would not provide a sufficient incentive for discouraging repeated

bid withdrawals in successive auctions. Many bidders would be willing to pay 10% or even 20% at the end of a given auction as an interim payment, hoping to recover all or most of this money at the end of a subsequent auction.

The most effective technique for discouraging repeated bid withdrawals in successive auctions is to make each auction a completely independent event. All bidder obligations should be settled at the end of each auction, with no obligation continuing forward that is contingent on the outcome of a successive auction. The current two-step bid withdrawal scheme (interim payment followed by permanent payment) should be scrapped in favor of a fixed-percentage, permanent bid withdrawal penalty at the end of each auction in the amount of 10% of a bidder's withdrawn high standing bid. By levying a fixed-percentage, final penalty at the end of each auction, bid withdrawals would be discouraged much more effectively than in the case of current procedures where many withdrawing bidders are willing to take a gamble that their withdrawn allotment will experience a price increase in a subsequent auction. This proposal would distribute the cost of bid withdrawals more effectively among withdrawing bidders, avoiding extreme withdrawal payments that may have a chilling effect on bidder participation. This proposal would also eliminate inequitable situations where a withdrawal payment grossly exceeds the amount of another bidder's subsequent winning bid. This is especially important if the bidder is a small business or sole proprietorship where the bidder faces financial ruin or bankruptcy at the hands of a withdrawal payment equivalent to five or ten years of hard-earned income, and far in excess of the fair market value of the permit in question.

C. Many of the vacant allotments that exist today were created by insincere proposals.

As stated in the Mullaney Comment (page 3, first paragraph, lines 8-14), “many of the vacant allotments that exist today were created by insincere proposals....Unwanted allotments clog the band preventing the creation of desirable allotments or upgrades to existing facilities. Unwanted allotments should be deleted.” We concur.

Although it is desirable to initiate new service to a community as expeditiously as possible, applicants are not going to construct new facilities unless it would be economically feasible to do so. For example, using the coordinates of an existing vacant allotment in California and assuming full Class A facilities, it appears that approximately 160 people would reside within the 60-dBu contour of the station, despite the fact that no significant terrain shielding exists.

If the original proponent of this California allotment had studied the area more carefully, they might have suggested any of a number of more appropriate cities of license. Similar concerns apply to other Auction 68 allotments. In selecting a city of license for a proposed allotment, it is good practice to ensure that the predicted 60-dBu field strength contour will encompass a sufficient number of people so as to support an economically feasible operation.

D. In an effort to substantially enhance the desirability of the Auction 68 allotments for potential bidders, thereby enhancing auction efficiency and profitability, the FCC should on its own motion reallocate the Auction 68 allotments to new towns, such that use of a given channel at the presently existing location is mutually exclusive with use of the channel at the newly assigned location.

The Mullaney Comments (page 3, lines 13-14) indicate that unwanted allotments should be deleted. We believe that such an extreme measure may not be warranted. Although many of the Auction 68 allotments could be

relocated to appropriate cities of license that are mutually exclusive with their present allocations, the current procedure to do so is unnecessarily cumbersome and time-consuming. In an effort to substantially enhance the desirability of the Auction 68 allotments for potential bidders, thereby enhancing auction efficiency and profitability, the FCC should on its own motion reallocate the Auction 68 allotments to new towns. Use of the channel in the new town should be mutually exclusive with use of the channel at its present location. In this manner, service may be initiated more expeditiously for cities and towns which truly have a need for new service, while at the same time eliminating undesirable allotments that no one wants.

E. In order to facilitate city of license changes for the Auction 68 allotments, winning bidders should have standing to file a Petition under 1.420(i) immediately upon tendering final payment for the allotment to the FCC.

The allotments offered in Auction 68 differ from the remainder of the Auction 37 and 62 allotments in that the Auction 68 allotments still remain unsold. Four of the allotments proposed herein remain unsold after two auctions (Mullaney Comment, page 3, lines 9-10). Accordingly, it may be appropriate to enhance the desirability of these allotments, so as to enhance auction efficiency and profitability. Mullaney has observed (Mullaney Comment, page 3, lines 15-19) that a winning bidder's final payment is now due within 20 days of the close of the auction public notice. In order to enhance the desirability of the Auction 68 allotments, the Commission should facilitate city of license changes by according winning bidders standing to file petitions under 1.420(i) immediately upon tendering final payment to the FCC.

Respectfully Submitted this 13th Day of September 2006:

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